CUNA MUTUAL GROUP

Lending Focus - 2021

Benchmark Survey Insights

Lending in an Era of Uncertainty

Lending is the Backbone for Many Credit Unions

Credit unions are as diverse as their members and are faced with finding ways to maximize success by embracing the lending landscape. Competition, the economy, and consumer behavior is forcing this change. The traditional consumer lending process has just about become obsolete in terms of efficiency and access to members.

Unfortunately, credit unions are often challenged to sustainably offer products and services that address the unique needs of a myriad of members or potential members. Time-intensive, manual processes and a labor-intensive business model are impacting many from meeting the enormous demand that still exists in the marketplace. Consumers are telling us that they want fast and simple solutions that link with their connected lives.

> *The pandemic has been portrayed as banking's greatest disruptor of all time, propelling changes in months that would have taken years.*
>
> The Financial Brand - October 2020

Reshaping of the Lending Landscape

Business disruption in 2020 had a significant impact on credit union balance sheets. The high unemployment rate reduced loan demand and slowed consumer spending. While the current interest rate environment is good for borrowers, it has been devastating for credit union net interest margins. A double-edge sword is the influx of deposits which fueled credit union balance sheet growth in 2020. The challenge now, is how to deploy the newly acquired liquidity.

In 2021, credit unions – representing a range of asset sizes - participated in our **Lending Benchmark Survey** to share insights on their programs, areas of focus, and loss control methods. These results and insights represent peer feedback from those credit unions that participated in the Benchmark Survey. Use these insights to help shape your lending strategies and focus.

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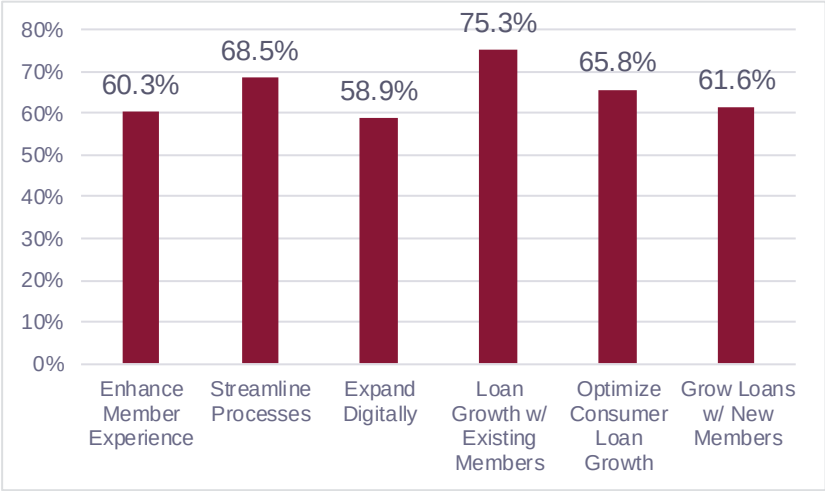
Benchmark Question: What is your lending focus for 2021?

Credit unions responded that more focus and priority will be placed on improving the member experience, streamlining processes and productivity, expanding digital lending, and growing consumer loans with new and existing members [see chart]. Nearly 20% of respondents suggested that 2021 will entail less focus on introducing new loan offerings.



Clearly, the expectations of the borrower have shifted. While the interest rate and closing costs on loans are still primary considerations; the speed, simplicity, transparency and member service aspect has grown in importance.

Credit unions can expect:

- Increased automation and digitization
- Hyper-personalized and proactive advice and pricing
- More engaging and dynamic member experience
- More choice to interact – with less need to visit the credit union location
- Additional eyes on what you're doing

Do More Lending Digitally

Delivery channels are changing predictably based on technology advances and the current competitive environment. Digitization is about adapting to compete in an increasingly digital world. The lending function for credit unions is no different. Credit unions in America are as diverse as their members but they are faced with finding ways to maximize success by embracing the digital lending landscape.

Success in the digital landscape depends on the ability to eliminate friction and provide consistency across all channels. Regardless of your operational structure, the member expects a seamless experience.

Influenced by easy, intuitive digital experiences

Almost two-thirds of people who apply for loans now do so either partially or fully online

Source: Fiserv consumer trends survey

Full integration means the ability to switch methods of engagement, i.e., from a mobile device to a branch or call center. Another important feature is the ability to save an application, at any point in the process, and resume later, potentially on a different channel. This is necessary to reduce abandoned applications. The expectation is a prompt decision and requires an auto-decision tool to approve the loan based on established parameters. The industry standard is approaching 30-seconds from submission to decision.

Digital lending addresses the top lending priorities identified in the Benchmark Survey. By expanding lending digitally, it can improve the member experience - meeting members where they are - streamline processes and productivity through automation, and also offers the opportunity to grow loans with new and existing members by attracting a new generation of tech-savvy borrowers.

Consumers have adapted to a more remote world by drastically changing how they buy products and approach financial transactions. Most expect an acceleration of the existing trend toward more mobile and digital banking and less branch banking.

Benchmark Question: **What are your most concerning lending risks?**

Overwhelmingly, and not surprisingly, loan growth and compliance concerns were the most significant for credit unions. In fact, **more than 80% suggested loan growth was a concern**. Rounding out the top five concerns were employee training, collections/default management, and member scams and fraud.

01 Loan Growth

02 Compliance

03 Employee Training

04 Default Management & Collection

05 Member Scams & Fraud

For many credit unions, technology may be the answer to address loan growth concerns. Regardless of asset size, credit unions that implement intuitive, immediate, and inspired digital lending experiences can improve their ability to gain market share – and position their organizations to win by delivering a better digital borrower experience and decreased time to close.

Credit unions should expect modest loan and membership growth of 5.0% and 3.0%, respectively, in 2021, before returning to long-run averages of 8.0% and 3.5% in 2022. Loan and membership growth will be bolstered by a rebound in auto loans, which make up one-third of outstanding loan balances at credit unions.

CUNA Mutual Group – 2nd Quarter Credit Union Economic Forecast

52% find compliance as the most concerning lending risk

Compliance and regulatory risk is an ongoing concern for credit unions and establishing compliant operations can be challenging. It often increases the cost of service and sometimes making the delivery of great member experience more difficult.

Unfortunately, regulators have been ratcheting up enforcement activity and credit unions face expanded expectations that can lead to higher costs and losses from escalating litigation, penalties, and staffing needs. In addition, many expect the new administration to focus more on consumer protection in regulation and enforcement actions across the business landscape

NCUA states their regulatory priorities for 2021 to focus on the CARES Act, specifically:

- Loan Modifications
- Reporting to Credit Reporting Agencies
- Mortgage Forbearance
- Fair Lending

Fair Lending is also a significant source of credit union losses as proven through claims at CUNA Mutual Group. Credit unions are encouraged to document efforts to prudently provide relief to borrowers affected by COVID-19 as supported by: board oversight; employee training; corrective action taken; and response to member complaints.

Only one of five are concerned with Data Protection

Surprisingly, less than 20% of Survey respondents identified data protection as the most concerning risk. Two questions come to mind:

- Does the lending team feel that data protection and cybersecurity efforts are under control?
- Is the thought that data protection is not a lending risk based on these results?

Cybersecurity and data governance need to run horizontally through your entire credit union. It is not just an IT problem. With so much at stake, cybersecurity must be a top-tier risk that receives the full attention in all functional areas at your credit union.

Data governance is the overall management of the availability, usability, integrity and security of data used in an enterprise. As credit unions continue the expansion of products and services to their membership this will lead to more data being gathered. A formalized data governance program should be in place to assist them in the management of data as well as to provide to examiners, regulators and auditors.

Data governance is not a one-time event but rather an ongoing process that involves the classification, accuracy integrity, storage, availability and security of the data. You should be able to answer these questions:

- Who has access to what?
- Who should have access to what?
- How is that access being used and how is it being controlled?

Benchmark Question: Does your compliance / legal department inform lending of new compliance issues, changes, and regulatory requirements?

56.2% Confirm that their compliance and/or legal department does a good job of communicating regulatory requirements, leaving 44% of credit unions that receive communication inconsistently, or not at all.

Credit unions manage their exposure to compliance risk through a comprehensive compliance program, often referred to as a **compliance management system (CMS)**. These components are essential:

- Board of Directors and Senior Management Oversight
- Policies and Procedures
- Training
- Monitoring and Corrective Action
- Member Complaint Response
- Compliance Audit

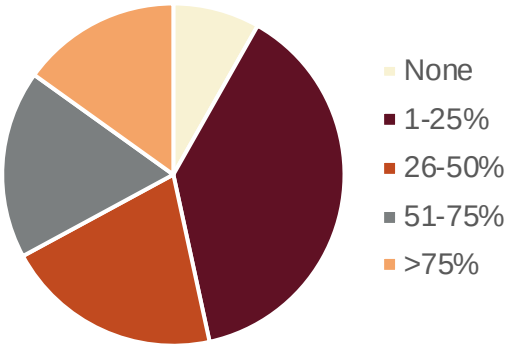
Note that the CMS is aligned with the stated examination objectives for 2021. The depth of detail for each component will vary based on your credit union's size and complexity but the component that is relative to our survey, is that a CMS formalizes the compliance function and provides accountability to the Board of Directors and Senior management.

To maintain a sound compliance program, training is essential. A Compliance Training Program should be developed that ensures all personnel are generally familiar with the consumer protection laws and that they receive comprehensive training on Regulatory Requirements directly affecting their areas of responsibility

Benchmark Question: **Our members can apply for loans…**

Over **50% indicated that members can apply for loans using a variety of channels**, including; in-person, from their website, their call center, using their mobile app, and at the auto dealership(s).

Virtual Origination



Another surprising statistic is that for nearly 40% of all respondents, less than 25% of their consumer loans are originated and received through a virtual channel.

While it is possible that this is an indication of varying credit union sizes that responded; a fully integrated digital lending process may not be the right fit for every credit union and/or their membership base. The good news is digital lending can take also take on multiple forms, from automating small pieces to the full integration.

Benchmark Question: **Do you have a process in place to verify the authenticity of your member prior to loan disbursement?**

One of the most encouraging responses within the Survey is that more than 90% of respondents report having a process in place to verify the authenticity of a member prior to loan disbursement. Losses from account takeovers through online banking are increasing at an alarming rate. The online channel provides a cloak of anonymity for fraudsters, making it critical for staff to be alert and cautious when opening accounts and processing loan applications.

91.8%

Process in Place for Member Authentication

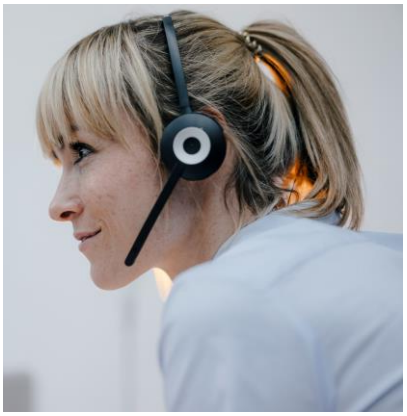
Losses stemming from identity theft-related loan fraud tend to be more severe in dollar amount than the losses associated with new account fraud. Once a fraudster opens an account, usually through the online channel, they immediately apply for loans, including unsecured loans, credit cards, and vehicle loans. These losses are increasing as more credit unions accept loan applications through the online channel.

Loan staff who process loan applications should be trained on how to spot fraudulent applications. They should carefully scrutinize credit reports, paystubs, and other support documents for irregularities including deductions for taxes, health benefits direct deposit information and that digits and decimals line up correctly, and numbers should add-up on paystubs. To prevent and reduce loan application fraud, your strategy and fraud detection system should include a combination of identity verification, account onboarding protection, and account monitoring.

Access additional resources regarding member authentication within the Protection Resource Center @ www.cunamutual.com/prc

Benchmark Question: **Do you proactively contact members with a prescreened, unsolicited offer of credit?**

34.2% Responded yes that they proactively contact members with a prescreened, unsolicited offer of credit



Given that some credit unions scaled back on preapproved marketing campaigns in recent years, now may be the time to consider re-entering the market. With share deposits growing quickly at double-digit rates, there is an abundance of liquidity to be deployed. For credit unions that re-visit prescreened offers as a source of loan growth, it is important to be familiar with the requirements of the Fair Credit Reporting Act (FCRA) and ensure you have a permissible purpose before using a member's consumer credit report.

Benchmark Question: **Do you periodically evaluate your loan portfolio to verify continued creditworthiness?**

57.5% Periodically evaluate your loan portfolio to verify continued credit worthiness

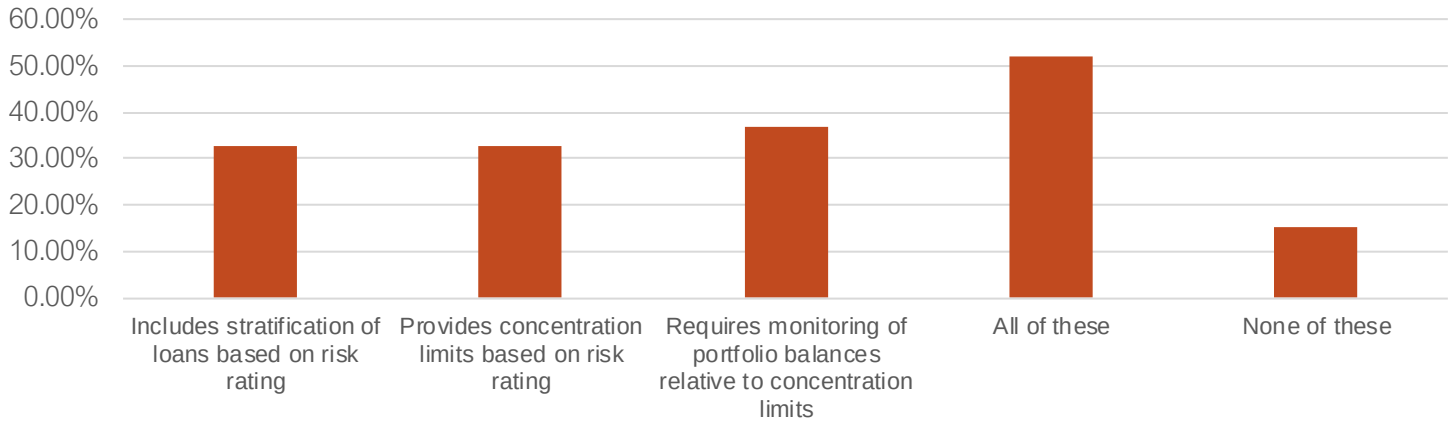
The process of taking a loan from application to funding is important but it is only 50% of the job of lending. The other 50% is portfolio management which means managing the ongoing risk in the portfolio to assure that loans are repaid, and losses are controlled.

To do this, credit unions must employ tools and procedures that monitor changes in risk and then direct actions to respond to the changes. Credit unions should manage the perfect storm of uncertainty and assess the risks of their loan portfolio by:

- Understanding the health of their loan portfolio.
- Adjusting models with more formal, data-driven refinements
- Combine and expand data management and analytics capabilities into credit-decisions and portfolio monitoring

It is recommended that you establish a flexible framework for your loan portfolios to prepare for whatever comes next.

Benchmark Question: Our risk-based lending strategy…



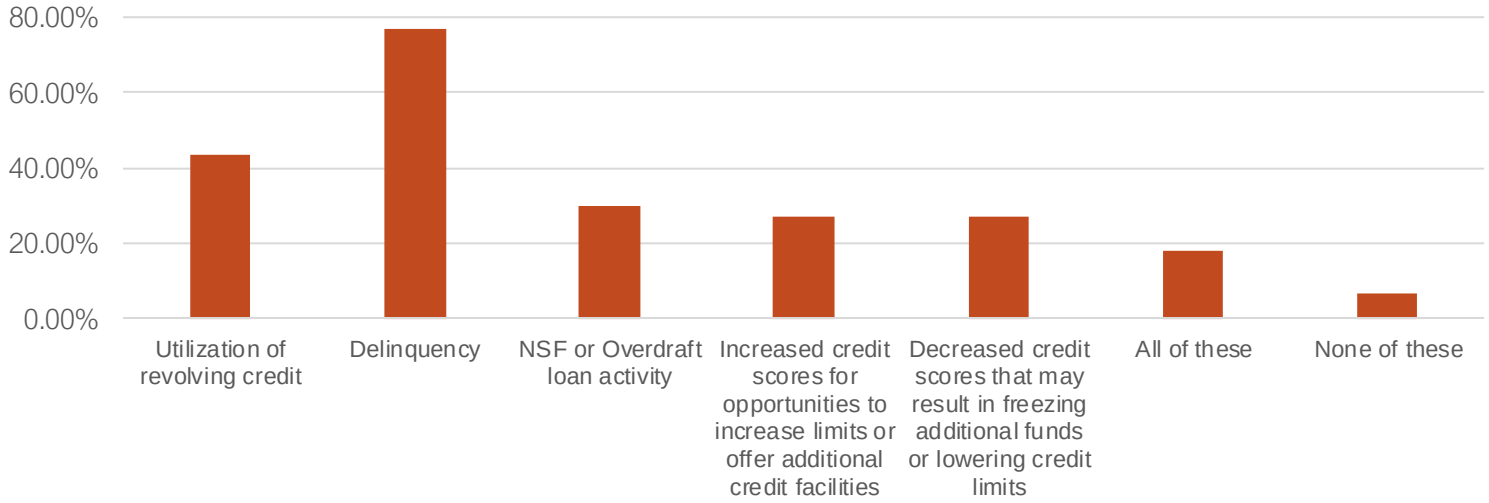
Loan concentration policies reflect the limits the credit union will allow for different categories of loans broken out by credit grade, loan type, loan source (participations/purchases, indirect, etc.) and so forth. Credit union officials and management have a fiduciary responsibility to identify, measure, monitor, and control concentration risk. Concentration risk must be managed in conjunction with credit, interest rate and liquidity risks; as a negative event in any category may have significant consequences on the other areas, as well as strategic and reputation risks.

Benchmark Question: The loan portfolio is monitored for…

A critical component of the lending process is loan servicing and portfolio monitoring. Loan servicing refers to the administrative aspect of a loan from the time the proceeds are dispersed to the borrower until the loan is fully paid or charged off. Maintaining a positive member experience should be a priority. Credit unions have a unique opportunity to strike a balance between good member service and results. If lenders can identify members at risk of default, they can effectively allocate resources and offer proactive solutions before the delinquency progresses.

Stay on top of changing risk profiles, especially for those who are experiencing hardship and could potentially become delinquent – even if they had no past delinquency history. Using internal data, like the information listed in this chart, can help you better identify the appropriate strategy by reviewing early indicators of financial distress.

The goal of early identification is to transition from simply collecting debts to enabling financial betterment. In some cases, that means working one-on-one with members to restructure loans and make payments more manageable.



Benchmark Question: Do you offer short-term loans, 45 days or less, to members for personal, family, or household purposes?

Almost 2/3 of the survey respondents indicated that they **do not offer short term loans**, commonly referred to as Payday Alternative Loans or PALs. Payday alternative loans are a more affordable alternative to payday loans and credit unions can increase loan volume by making this product available to members as a bridge to resolve a short-term financial crisis.

Payday Alternative Loans (PALS) were developed using guidelines created by the NCUA to allow credit unions to provide a more member friendly alternative to traditional Payday loans.

In contrast to traditional payday loans, PAL products offer more affordable options structured as follows:

- Available to members after 1-month of membership
- Loan amounts between $200 and $1,000
- Maximum Annual Percentage Rate (APR) of 28% and application fee of no more than $20
- Repaid in full within 1 to 6 months by installments. No rollovers allowed.
- Members may have no more than one PAL outstanding at a time and no more than 3 PALs within a 6-month period

In September of 2019 NCUA added a second PAL option, PALs II which expanded the features to include:

- Loan amounts up to $2,000
- Terms up to 12 months with repayment in installments
- Available at time of membership. 1-month waiting period is removed
- Members may have no more than 1 PAL II loan at a time

PALs are possibly another arrow in the quiver to serve members and generate loans to utilize excess liquidity. Credit unions have a long history of helping members through difficult times with small-dollar loans and other responsible credit. In addition to PAL and PAL II, credit unions can offer small-dollar loans through a variety of products including open-end lines of credit, closed-end installment loans, or appropriately structured single payment loans. Unlike the other types of small-dollar loans, PALs may not contain any single payment or balloon payment feature.

For all products, credit unions are encouraged to offer loans in a manner that provides fair treatment of members and complies with applicable statutes and regulations.

69.9% Confirmed that their lending-related marketing documents are reviewed and approved for regulatory compliance

Reported key lending activities are not handled by a third-party on your credit union's behalf. **72.6%**

21.9% Have established a credit exposure strategy for individual members or groups of affiliated members. In general, individual member borrower and segment assessments have become more important.

Benchmark Question: **How have your lending programs changed over the last 12-18 months?**

Before the pandemic, financial institutions were already dealing with a myriad of challenges around loan administration, accurately stressing the portfolio, and dealing with examiner scrutiny. Over the last 12-18 months, credit unions have been adjusting to the new dynamics and exploring potential new approaches to challenges.

Loan Volume

Staff Turnover

Delinquencies / Repossessions

While **loan growth** is key, the Benchmark insights suggest that 35.6% witnessed an increase in loan volume and 41.1% saw a decrease.

More than 95% report that **delinquencies / repossessions** have stayed the same or decreased. Members and small businesses may suffer from prolonged unemployment and the inability to make payments – making loan servicing and collections even more critical. It will be important to stay on top of changing risk profiles, especially for those who are experiencing hardship and could potentially become delinquent – even if they had no past delinquency history. Some members may accept deferments or forbearance, even if they have suffered no disruption of income. In other words, they may be holding on to cash because they are not sure what to expect or how long it will take for the economy to fully recover.

26% of respondents report that **staff turnover** has increased. Staff turnover can introduce and/or build upon weaknesses related to the management of internal controls and employee training. Internal controls will also help maintain the integrity of loan and collection policies and procedures, deter any employee considering noncompliance, and detect — at an early stage — when an employee is involved in a violation of policies or procedures.

Almost 2/3 reported that the level of **fraud** and **member complaints** remined the same over the last 12-18 months.

Wrap-Up

A successful, well-run lending program does not happen by accident. Keeping ahead of the complex array of ever-changing risks, compliance issues, and adapting to consumer behaviors and expectations that are impacting credit unions requires keen awareness, effective preparation, and loss control scrutiny.

While each credit union has its own unique risk footprint, these Benchmark Survey Insights introduce insights, trends, and risks that most likely should be on your radar as you strategize the ins and outs of your lending program.

*If you'd like to discuss these insights or lending risks in more detail, simply schedule a no-cost personalized discussion with a CUNA Mutual Group Risk Consultant or contact us at riskconsultant@cunamutual.com or at **800.637.2676**.*

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